No. 94-1292

In the Supreme Court of the United States

OCTOBER TERM, 1994

BRUCE BABBITT, SECRETARY OF THE INTERIOR, ET AL., PETITIONERS

v.

PHILLIPS PETROLEUM COMPANY, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE PETITIONERS

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Respondents do not dispute the existence of a conflict among the courts of appeals over the use of the "substantial impact" test to determine whether an agency action requires notice-and-comment rulemaking under the Administrative Procedure Act (APA), 5 U.S.C. 553—a question on which this Court has previously granted review (see Pet. 14-15). They do not contest that the court below relied on the "substantial impact" test in requiring notice and comment for a "rule" that otherwise appeared to the court to fall "squarely within" an APA exemption.

Pet. App. 9a. And they do not defend the "substantial impact" test on its merits.

Respondents instead devote the bulk of their submissions to arguments based on inaccurate assertions about the nature and operation of the internal Minerals Management Service (MMS) "Procedure Paper" at issue in this case. Respondents contend, for example, that the paper "imposes substantive obligations" (ARCO Br. in Opp. 22), "forecloses alternative valuation methods" (*id.* at 23), and "forbids consideration of posted prices or the other factors enumerated in the [published valuation] regulation" (Phillips Br. in Opp. 11). See also, *e.g.*, Phillips Br. in Opp. 6-7, 9-10; ARCO Br. in Opp. 19. Respondents' arguments that the procedure paper is a "substantive rule" under "any reasonable analysis" (Phillips Br. in Opp. 10; see ARCO Br. in Opp. 19, 21-22) depend entirely on their misapprehension of the paper's purpose and effect. And those arguments do not, in any event, detract from the need for this Court's review to resolve not only the circuit conflict over the "substantial impact" test, but also broad and recurring questions concerning the scope of the three APA notice-and-comment exemptions that the court of appeals held inapplicable to this case.

1. As our petition explains (at 6-8, 14-22), the procedure paper is, in and of itself, no more than an internal enforcement policy memorandum prepared by agency compliance personnel for their own guidance in auditing the values used by lessees to calculate the royalties owed on particular by-products of their natural gas production. After the procedure paper was circulated within MMS, an auditor's determination that values and royalties were underreported on a given lease remained subject

to appeal by the lessee to the Director of MMS, and thereafter to the Interior Board of Land Appeals (IBLA). In any such appeal, the question remained whether MMS officials had reasonably determined that royalties had been underpaid. The governing legal standard remained that of the then-applicable regulation, 30 C.F.R. 206.150 (1987) (value for royalty purposes must "never be less than the fair market value"), and the final agency decisionmaker remained free to modify or reject determinations made at earlier stages in the administrative process.[1]

As the IBLA made clear in its decision on ARCO's administrative appeal of one of the orders at issue in this case, the procedure paper "did not require lessees to value their production by any specific method, nor did it modify any existing regulation." Pet. App. 117a. Indeed, in that case the IBLA—the only body authorized to speak for the Secretary on valuation matters contested by a lessee (see Pet. 16 n.4)—rejected a significant aspect of the procedure paper's "yardstick" methodology and remanded for a recomputation favorable to ARCO. Pet. App. 119a-120a; see Pet. 9-10, 16. And in other cases the Board has upheld the use of non-"yardstick" valuation methods for natural gas liquid products (NGLPs) in

[1] Respondent Phillips complains (Br. in Opp. 3) that the prospect of late payment charges on underpaid royalties puts it at "significant financial risk of misgauging the government's later assessment of the reasonable value of production." Any late payment charges that may be imposed, however, amount to no more than interest on the amount determined to have been underpaid. Those interest charges are required by 30 U.S.C. 1721(a), and reflect only a suitable measure of the value to the lessee (and the cost to the United States) of the delay in payment. See 30 C.F.R. 218.54.

appropriate circumstances. See Pet. 20-21 & n.6. The characterization of the procedure paper around which respondents have constructed their briefs in opposition is therefore simply inaccurate.

ARCO points out that a similar view of the procedure paper informed the court of appeals' determination—under the "substantial impact" test that we challenge—that notice-and-comment procedures were required in this case. Br. in Opp. 18-19, citing Pet. App. 10a-11a. ARCO cannot shield the court of appeals' error from review, however, by terming it a "factual finding" (Br. in Opp. 20). If the question of the procedure paper's proper place in the administrative scheme were a "factual" one, it would have been settled by the conclusions of the IBLA (Pet. App. 117a-118a) and the district court (*id.* at 62a-63a) that the paper "is interpretive in substance and application, and, * * * itself, is not the source of any substantial impact." *Id.* at 63a. But the question whether a particular agency document is a "rule" that must be promulgated in accordance with the notice-and-comment procedures of the APA is one of law, not of fact. Any subsidiary questions about the purpose and application of the procedure paper are readily answerable on the record in this case (particularly given the deference owed an agency's explication and application of its own materials and processes), and there is no impediment to this Court's correction of the court of appeals' legal error.

2. At various points ARCO defends its characterization of the procedure paper as a "final agency requirement," imposing substantive obligations, on the ground that one of the five NGLP valuation orders at issue here was reviewed and upheld (in part) by the IBLA (and the government thereafter did not

challenge the finality of the remaining orders for purposes of this litigation). Br. in Opp. 10, 15-17 & n.13. ARCO cannot disguise the nature of the procedure paper itself, however, by pointing out that particular administrative orders that rely, in whole or in part, on the paper's suggested valuation methodology in resolving individual valuation disputes become binding once the IBLA acts (or if the lessee fails to seek IBLA review within the time allowed).

After the IBLA ruled on the one administrative appeal taken by ARCO, it may be that subsequent appeals to the Board on substantially identical facts were not likely to produce a decision in ARCO's favor. See ARCO Br. in Opp. 17. That result, however, would be attributable to the precedential effect of the IBLA's prior decision adopting a modified version of the methodology contained in the procedure paper, rather than to any binding force of the paper itself. In this respect, the effect is the same as if MMS had urged the valuation methodology in a brief to the IBLA, and the IBLA had adopted those parts that the Board found persuasive. The fact that MMS wrote its views down for itself before writing them down for the Board cannot make the difference between a permissible adjudication and an impermissible clandestine "rulemaking."

The court of appeals did not invalidate the orders at issue here because of any question about the legal or factual propriety of the valuation decisions reached by MMS or the IBLA with respect to the particular leases and periods at issue in the orders themselves.[2] Rather, the court accepted respon-

[2] Respondents effectively concede that the valuation methodology adopted by MMS was substantively reasonable.

dents' facial challenge to MMS's ability to issue *any* royalty compliance order, even at the initial stage of the administrative enforcement process, based on the valuation methodology set out in the procedure paper, unless and until that methodology was adopted through notice-and-comment rule-making. That challenge, and the decision below, must stand or fall based on the proper application of the APA to the procedure paper. And that is the question presented by our petition. Pet. i.

3. Respondent Phillips cites this Court's recent decision in *Shalala* v. *Guernsey Memorial Hospital*, 115 S. Ct. 1232 (1995), for the proposition that an agency must undertake notice-and-comment rule-making whenever it "adopt[s] a new position inconsistent with * * * existing regulations." Phillips Br. in Opp. 10 (quoting *Guernsey Memorial Hospital*, 115 S. Ct. at 1239). Phillips maintains that the procedure paper cannot fall within the APA's exception for "interpretative rules," 5 U.S.C. 553(b)(A), because the paper "did not even acknowledge the existence" of the governing regulation, and in fact proceeded "in direct contravention of the [regulation's] express terms." Br. in Opp. 11. As we have pointed out (Pet. 18-19 & n.5), however, the paper in fact begins by identifying a practical valuation problem and stating the generally applicable regulatory standard, and it then sets out an admin-

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See ARCO Br. in Opp. 6 (there is "no reason why ARCO could not, and would not, have used the [prices] specified in the Procedure Paper" had it known of the paper); Phillips Br. in Opp. 11 (agency "was free to make the substantive judgment that 'spot prices * * * are a better indicator of value than posted prices'" (quoting Pet. App. 106a)).

istrative view about how the identified issue should be resolved under several variations of a specific factual scenario. See Pet. App. 130a. And rather than ignoring or "forbid[ding] consideration" (Phillips Br. in Opp. 11) of the factors listed in the regulation, the paper specifically considers all of them—or, in the case of "posted prices," the best analogue available under the particular circumstances involved. See Pet. 19 n.5.[3]

Indeed, on any proper understanding of the origins and functions of the procedure paper, *Guernsey Memorial Hospital* can only support the government's position in this case. The provision of the Medicare Provider Reimbursement Manual (PRM) at issue in *Guernsey Memorial Hospital* was actively provided to relevant members of the public, and was at least to some extent authoritative as a public expression of the view of relevant agency officials concerning the proper application of the Medicare Act and the agency's general regulations to a particular cost reimbursement situation. See 115 S. Ct. at 1234, 1239. The procedure paper at issue here, by contrast, is an internal, non-binding statement of general enforcement policy, developed by and for front-line agency compliance personnel for use in the initial stages of what is essentially a system of case-by-case adjudication. Even if such a document may properly

[3] In their extensive reliance on the governing regulation, respondents studiously ignore its injunction to consider "other relevant matters," 30 C.F.R. 206.150 (1987)—a category that would certainly include the spot prices that the paper's authors determined (Pet. App. 132a) generally "represent[ed] the best available price source" in the special context of NGLPs used internally by a lessee or disposed of in non-arm's-length transactions. Compare, *e.g.*, Phillips Br. in Opp. 11-12.

be characterized as a "rule" at all, see Pet. 15-17, it surely cannot be *less* of an "informal * * * guideline" than the provision that the *Guernsey Memorial Hospital* Court characterized as a "prototypical example" of the sort of "interpretive rule" that is *not* subject to notice-and-comment rulemaking under the APA. *Guernsey Memorial Hospital*, 115 S. Ct. at 1234, 1239.

As the dissent in *Guernsey Memorial Hospital* recognized, a government agency

> certainly cannot foresee every factual scenario with which it may be presented in administering its programs; to fill in the gaps, it must rely on adjudication of particular cases and other forms of agency action, such as the promulgation of interpretive rules and policy statements, that give effect to the statutory principles and the background methods embodied in the regulations.

115 S. Ct. at 1243-1244 (O'Connor, J., dissenting). The MMS "procedure paper" at issue in this case did, at most, no more than that. Every federal agency that has compliance and enforcement responsibilities must have the ability to undertake internal consultation and coordination of the sort embodied in the MMS paper, and to issue and defend orders based on theories so developed, without submitting every written product of those internal processes for public notice and comment. Respondents offer no persuasive answer to our explanation (Pet. 26-28) of why the court of appeals' decision to the contrary not only conflicts with decisions of other courts of appeals, but also poses a serious threat to the orderly and efficient conduct of the government's administrative business.

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For the foregoing reasons and those set forth in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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